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IN THE

SUPREME COURT

OF THE UNITED STATES

October 1971 Term

No.

TOWN PARK HOTEL CORPORATION,
Petitioner
versus
COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals
for the Sixth Circuit

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OPINIONS

The Opinion of the United States Tax Court is reported in 29 T. C. M. 1150. The Opinion of the Court of Appeals is reported at 446 F. 2d 878 (6th Cir., 1971).

JURISDICTION

The judgment of the Court of Appeals for the Sixth Circuit was made and entered on August 10, 1971. The jurisdiction of this Court is invoked under 28 U. S. C. 1254 (1).

QUESTION PRESENTED FOR REVIEW

Does an accrual basis taxpayer in a condemnation proceeding in Tennessee realize gain pursuant to Section 1033(a)(3)(A) and (B) of the Internal Revenue Code of 1954, as amended, when it withdraws from the court, prior to a determination of the proper amount of the award, the deposit as submitted by the condemnor, where the amount of the deposit exceeds the tax basis of the condemned property in the hands of the taxpayer?

STATUTES INVOLVED

1. Internal Revenue Code of 1954, Section 1033(a)(3)(A) and (B), 26 U. S. C., Section 1033.

2. Tennessee Statutes, Sections 23-1526 through Section 23-1541 of the Tennessee Code Annotated.

STATEMENT OF THE CASE

The issue presented by this petition concerns the application of the "claim of right" doctrine first enunciated by the United States Supreme Court in **North American Oil v. Burnet**, 286 U. S. 417, 424 (1932) to the use by Petitioner of funds deposited in a court pursuant to the laws of the State of Tennessee.

Town Park Hotel Corporation (hereinafter referred to as "Petitioner") was a Tennessee corporation, which owned and operated a motel, restaurant and related facilities, in Memphis, Tennessee. (Appendix of Petitioner-Appellant in the United States Court of Appeals for the Sixth Circuit, hereinafter cited "Pet. C. A. App., p. 1").

Petitioner maintained its records and filed its income tax returns on the accrual method of accounting with its fiscal year ending on June 30. (Pet. C. A. App., p. 2).

On August 14, 1964, the Commissioner of Highways and Public Works of the State of Tennessee filed a petition of condemnation in the Circuit Court of Shelby County, Memphis, Tennessee against Petitioner for the purpose of acquiring a portion of Petitioner's land and building. With the petition the State of Tennessee deposited the sum of $722,476.00 with the court. (Pet. C. A. App., p. 2).

On August 21, 1964, the Circuit Court entered an order granting immediate legal possession, but not legal title, to the State of Tennessee. (Pet. C. A. App., p. 3).

Pursuant to a request by Petitioner, the Circuit Court ordered disbursement of the deposit to Petitioner on September 30, 1964, without prejudice to the rights of either party and with Petitioner agreeing to refund any difference if the final award in the case was less than the deposit. The Petitioner then advanced the withdrawn deposit to affiliated corporations. (Pet. C. A. App., p. 3).

Pursuant to an oral order of the Circuit Court the State of Tennessee filed an amendment to petition to correct an error in the description of the property in the petition for condemnation. (Pet. C. A. App., p. 3).

On April 16, 1966, the Circuit Court entered a decree reciting a jury verdict awarding the Petitioner $725,000.00 as the fair cash market value of the land and improvements taken and also incidental damages of $215,000.00 plus interest, and at that time divested the title of Petitioner in the property and vested said title in the State of Tennessee. (Pet. C. A. App., p. 3).

On April 28, 1967, Petitioner expended the sum of $1,678,781.34 for the purchase of a motel similar and related in service and use to the motel property condemned by the State of Tennessee. (Pet. C. A. App., p. 4).

Petitioner's basis in the property condemned was $272,721.67 which is $449,754.33 less than the amount deposited with the Circuit Court and withdrawn by Petitioner on September 30, 1964. (Pet. C. A. App., p. 4).

Petitioner did not report a gain on the disposition of this property pursuant to Section 1033(a)(3)(A) and (B) of the Internal Revenue Code of 1954.

The Commissioner of Internal Revenue determined that Petitioner had realized gain when it withdrew the condemnation deposit on September 30, 1964 from the State Court. As a result the Commissioner determined that a deficiency in Petitioner's Federal income tax for the fiscal year ended June 30, 1965, in the amount of $112,223.74 after permitting a credit against such deficiency in the amount of $214.84 as a result of additional expenses allowable to Petitioner.

The Petitioner protested the deficiency using every appellate remedy available to it through the Internal Revenue Service. After receiving a ninety-day notice of deficiency, Petitioner filed a petition in the United States Tax Court protesting the proposed deficiency pursuant to 26 U. S. C. 7442.

The Tax Court determined that the deficiency was correct and that gain was realized by Petitioner in 1964 when it withdrew the condemnation deposit from the State Court under the "claim of right" doctrine.

Pursuant to 26 U. S. C. 7482, Petitioner perfected

an appeal to the United States Court of Appeals for the Sixth Circuit. The Court of Appeals affirmed the decision of the Tax Court.

ARGUMENT

The "claim of right" doctrine as established by the Supreme Court of the United States in North American Oil v. Burnet, 286 U. S. 417, 424 (1932) and defined in Healy v. Commissioner, 345 U. S. 278, 282 (1953) is not applicable to the withdrawal of proceeds from a Tennessee Court in a condemnation case in accordance with the laws of the State of Tennessee prior to a determination of rights of the parties.

During Petitioner's fiscal year ending June 30, 1965, Petitioner's property in Tennessee was condemned, and the state, pursuant to the Tennessee statutes, deposited an amount greater than Petitioner's basis with the State Court. The state took possession of the property and Petitioner withdrew the deposit from the State Court pending a final determination of the condemnation proceedings. During the fiscal year ended June 30, 1966, the trial of the condemnation proceedings was completed and Petitioner was awarded an amount in excess of that previously deposited by the state and the state was given title to Petitioner's property. During the fiscal year ended June 30, 1967, Petitioner invested an amount in excess of the condemnation award with the opinion that it had complied with the nonrecognition of gain provisions of Section 1033(a) (3) of the Internal Revenue Code of 1954, having realized a gain on the proceedings during the fiscal year ended June 30, 1966. The Commissioner, as affirmed by the Tax Court and the Court of Appeals, has taken the position that when Petitioner withdrew the deposit from the State Court during the fiscal year ended

June 30, 1965, it realized gain under the "claim of right" doctrine established by the Supreme Court in **North American Oil** v. **Burnet,** supra, and therefore did not reinvest the proceeds of the condemnation within the one year nonrecognition of gain provisions. Petitioner is of the belief that based on the facts of this case the "claim of right" doctrine is not applicable to the withdrawal of the deposit and the decisions are in conflict with the opinions of the Supreme Court of the United States and the United States Court of Appeals for the Fifth Circuit.

Although the "claim of right" doctrine was first established by the Supreme Court in **North American Oil** v. **Burnet,** supra, it was first defined by the Supreme Court in **Healy** v. **Commissioner,** 345 U. S. 278, 282 (1953). The Court stated:

> "The phrase 'claim of right' is a term known of old to lawyers. Its typical use has been in real property law in dealing with title by adverse possession, where the rule has been that title can be acquired by adverse possession only if the occupant claims that he has a right to be in possession **as owner.** The use of the term in the field of income taxation is analogous. There is a claim of right when funds are received and treated by a taxpayer as belonging to him. The fact that subsequently the claim is found to be invalid by a court does not change the fact that the claim did exist. A mistaken claim is nonetheless a claim***." (Emphasis added).

In order to determine whether Petitioner had a right to claim to be in possession **as owner,** one must examine the statutes and cases in the State of Tennessee pertaining to condemnation proceedings.

The statutory law in Tennessee is clear concerning a

condemnation proceeding. At the time the state institutes the condemnation proceedings it deposits into court the amount of damages to which it deems the owner entitled. The state then becomes entitled to have possession, but not legal title, of the condemned property. TCA 23-1529, 1530, (Appendix, p. 15). If the owner is not satisfied with the deposit he is entitled to have a trial by jury to determine the amount of compensation to which he is entitled. TCA 23-1532, 1535 (Appendix, p. 17). Following the determination of the compensation by the jury the court will vest title in the condemned property to the state. Prior to the jury trial, without prejudice to either party, the owner may withdraw from the court the amount of the deposit provided the owner agrees to refund the difference between the deposit and the amount of the award by the jury if the award by the jury is less than the deposit. TCA 23-1533 (Appendix, p. 17).

The amount deposited by the state may not have any relationship to the damages ultimately awarded the owner of the property. The Tennessee courts have clearly stated, "What the condemner deposits in court does not fix the damages in any way in the world". **Catlett v. State**, 207 Tenn. 1, 336 S. W. 2d 8, 12 (1960); **J. D. Kennedy, et. al. v. City of Chattanooga**, 56 Tenn. App. 198, 405 S. W. 2d 653, 656 (1966). In Tennessee it is improper to state to the jury at the time of the trial the amount deposited in court by the condemnor and it has nothing to do with the proof. **Parker v. Pack**, 437 S. W. 2d 251, 253 (1968). In **Kennedy v. City of Chattanooga**, supra, the court referring to the deposit stated, "We think it merely a prerequisite to the right to immediate possession". The deposit is merely a form of security for the owner while the state has possession. As stated by the court in **Kennedy v. City of Chattanooga**,

supra, "We think the intent and purpose of the 1959 Act was to **protect** the owner by having the money in court and when the money has been deposited to give the condemnor the privilege of almost immediate possession". (Emphasis added).

It is true that the owner in a condemnation proceeding has the use of the deposit while it is in his possession. However, at any time prior to the jury retiring to consider the verdict, the state could have withdrawn from the condemnation proceedings, returned possession of the condemned property to the owner and received from the owner the deposit held by the owner. **Henry A. Williams, et. al. v. McMinn County, Tennessee,** 209 Tenn. 236, 352 S. W. 2d 430, 433 (1961); **Huff v. Department of Highways** 3 Tenn. App. 277 (1926). It is clear from the above that under the laws of the State of Tennessee, Petitioner had the right of possession of the deposit but in no way had a claim of ownership.

When Petitioner withdrew the deposit from the State Court, it merely received possession of the money in the same way the state received possession of Petitioner's property. Petitioner loaned the deposit to its affiliated corporations pending the result of the condemnation proceedings. Neither party had the right to claim ownership in the other's property, although each party had the right to use the other's property. Petitioner could not withdraw from the condemnation proceedings, but the state could withdraw and return possession of Petitioner's property to Petitioner and receive a return of its deposit. In addition, if the condemnation proceedings were concluded and the court awarded an amount less than the deposit, Petitioner must return the excess to the state. Under these circumstances Petitioner could not and did not claim to

be in possession of the deposit as owner under the "claim of right" doctrine as defined by the Supreme Court in **Healy v. Commissioner,** supra.

Petitioner is further of the opinion that the United States Court of Appeals for the Fifth Circuit interprets the "claim of right" doctrine in the same manner as Petitioner and in conflict with the courts involved in this case. In **Clinton Hotel Realty Corporation v. Commissioner of Internal Revenue,** 128 F. 2d 968 (C. A. 5, 1942) the taxpayer, Clinton Hotel Realty Corporation leased its property to another receiving in the first taxable year a $21,000 deposit and the first year's rental of $21,000. Clinton Hotel had possession and use of the deposit with the understanding that the deposit would be applied as stipulated damages in the event of lessee vacating the premises or defaulting in the lease and as payment of the last year's rental if the lease stayed in effect to that time. The only way in which the deposit could return to the lessee would be in the event the premises were totally destroyed. The Commissioner and the Board of Tax Appeals held that the deposit was income to Clinton Hotel in the year received. In reversing the Board of Tax Appeals, the court said:

> "It is not denied that if the $21,000 was paid and received as rent in advance, it was taxable, though not yet earned. United States v. Boston & Providence R. R. Corp., 1 Cir., 87 F. 2d 123; Renwick v. United States, 7 Cir., 87 F. 2d 123; Commissioner v. Lyon, 9 Cir., 97 F. 2d 70. On the other hand, if it was paid and received as security, with no present right or claim of full ownership, it would not be presently income, although it was expected finally to be applied in payment of the last year's rent if nothing happened to prevent. Barker's Estate v. Commissioner, 13 B. T. A. 562; Warren

> Service Corp. v. Commissioner, 2 Cir., 110 F. 2d 723. In the latter situation, though the money is rightfully received, and if the parties so intend may be freely used, yet because of the acknowledged liability to account for it, there is no gain; just as in borrowing there is none. The case of North American Oil Consolidated v. Burnet, 286 U. S. 417, 424, 52 S. Ct. 613, 76 L. Ed. 1197, has no application, for the recipient of the money there claimed it was fully his, he acknowledged no right in another, and the holding was that a contrary claim by that other which might prove good would not prevent the receipt of the money being present income."

In the **Clinton Hotel Realty Corporation** case the only way in which the lessee could receive a return of its deposit was if the leased premises were destroyed. Yet because of this condition the court correctly noted that there could be no present right or claim of ownership as is required under the "claim of right" doctrine. Petitioner in the case at hand (1) had no legal title in the deposit, (2) was subject to returning possession of the money whenever the state in its sole discretion decided to withdraw from the condemnation proceeding prior to jury consideration of the amount of any award and (3) was subject to returning any amount of the deposit in excess of the jury award. The conditions under which the deposit is received by Petitioner are more restrictive than the restrictions on Clinton Hotel Realty Corporation above, and clearly, the "claim of right" doctrine is not applicable.

Petitioner respectfully urges that the United States Court of Appeals for the Sixth Circuit has expanded the "claim of right" doctrine beyond the intent of the Supreme Court and in conflict with the Supreme Court

of the United States and the United States Court of Appeals for the Fifth Circuit.

CONCLUSION

For the foregoing reasons Petitioner respectfully prays that this Petition for a Writ of Certiorari be granted.

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APPENDIX

Internal Revenue Code of 1954:

Section 1033 (a) (3) (A) and (B)

Sec. 1033 (a) GENERAL RULE.—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted—

* * *

(3) CONVERSION INTO MONEY WHERE DISPOSITION OCCURRED AFTER 1950.—Into money or into property not similar or related in service or use to the converted property, and the disposition of the converted property (as defined in paragraph (2) occurred after December 31, 1950, the gain (if any) shall be recognized except to the extent hereinafter provided in this paragraph:

(A) NONRECOGNITION OF GAIN.—If the taxpayer during the period specified in subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stocks. Such election shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe. For purposes of this paragraph—

(i) no property or stock acquired before the

disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(ii) the taxpayer shall be considered to have purchased property or stock only if, but for the provisions of subsection (c) of this section, the unadjusted basis of such property or stock would be its cost within the meaning of section 1012.

(B) PERIOD WITHIN WHICH PROPERTY MUST BE PLACED.—The period referred to in subparagraph (A) shall be the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is the earlier, and ending—

(i) one year after the close of the first taxable year in which any part of the gain upon the conversion is realized, or

(ii) subject to such terms and conditions as may be specified by the Secretary or his delegate, at the close of such later date as the Secretary or his delegate may designate on application by the taxpayer. Such application shall be made at such time and in such manner as the Secretary or his delegate may by regulations prescribe.

* * *

Tennessee Code 23-1526 through 23-1541

23-1526. Payments into court at commencement of condemnation proceedings.—Whenever the state of Tennessee, its counties or municipalities, institutes a condemnation proceeding in any court, under the pro-

visions of chapters 14 or 15 of title 23, to acquire any property or property rights, such condemner may deposit with the clerk of such court at the time of the filing of the petition such amount as it shall determine that the owner is entitled to and the owner may, if he so desires, make written request to said clerk to pay to him, without prejudice to any of his rights, said sum so deposited with the clerk, and the clerk shall pay to said owner the sum so deposited, provided the owner agrees to refund the difference between said sum and the final award in the case if the final award be less than the sum so paid into court or that a judgment may be entered against him in said case for the difference. Such payment to the property owner or into court shall in no wise limit or fix the amount to be allowed under subsequent proceedings in said case, and any further or additional sum that may be finally awarded in any subsequent proceedings shall bear interest from the date of the taking possession of the property or property rights condemned by the condemner provided, however, that no interest shall be allowed on the amount deposited with said clerk.

23-1527. Certain authorities excepted.—Section 23-1526 shall apply only to condemnation proceedings instituted by the state of Tennessee, its counties or municipalities, and shall not apply to any housing authority, association, or administration.

23-1528. Power of state, county or municipality to acquire right-of-way, lands or easements for road purposes.—The state of Tennessee, its counties or municipalities are hereby authorized and empowered to acquire by the exercise of the power of eminent domain, in the manner hereinafter set out, such right-of-way, land, material, easements and rights as may be deemed necessary, suitable or desirable for the construction,

reconstruction, maintenance, repair, drainage or protection of any street, road, highway, freeway or parkway by the official charged by law with the construction or maintenance of the same.

Sections 23-1529 through 23-1541 shall also be deemed, unless expressly stated to the contrary, and without incorporation or reference, to be a part of every section, or legislative act, present or future, which grants the power of condemnation to counties and municipalities for county and municipal purposes respectively, and the making of compensation in the manner therein set forth shall also be so implied; provided, however, that either party, upon filing a statement to that effect within five (5) days of the service or publication of the original petition, may elect to proceed under the provisions of § 23-1401 et seq. or § 23-1501 et seq.

23-1529. Deposit of amount of damages.—When any of the said governmental entities deems it necessary or desirable to condemn any property or property rights as set out in § 23-1528, it shall proceed to determine what it deems to be the amount of damages to which the owner is entitled because of the taking of said property or property rights, and shall deposit said amount with the clerk of the circuit or law court having jurisdiction in the county in which the same or a portion of the same is located, and shall file a petition in said court asking that the same be condemned and decreed to the condemner.

23-1530. Petition for condemnation—Possession of property.—Said petition shall name as defendants all persons who have or may have an interest in or lien upon said property or property rights, shall state the residence of each if known and if unknown that fact

shall be stated, shall contain a description of the property or property rights sought to be condemned, the civil district in which the same is located, a description of the project to be constructed and the amount of damages to which the condemner has determined that the owner will be entitled, which amount shall be deposited with said clerk, and shall pray that the property be condemned and decreed to the condemner. It shall not be necessary to specify the interest or claim of the several defendants.

Notice of the filing of said petition shall be given the owner of the property or property rights at least five (5) days prior to the taking of any additional steps in the case. If the owner is a nonresident of the state or unknown, notice shall be given by publication as provided by law in similar cases in chancery. After the expiration of five (5) days from the date of the giving of said notice if the right to take is not questioned, the condemner shall have the right to take possession of the property or property rights sought to be condemned and if necessary to place such condemner in possession thereof, the court shall issue a writ of possession to the sheriff of the county to put the condemner in possession.

23-1531. Acceptance by property owner of amount deposited.—If the owner is satisfied with the amount deposited by the condemner with the clerk of the court, he may file with said clerk a statement, duly sworn to, stating that he is the owner of the property or property rights described in the petition and that he accepts the amount deposited with the clerk as full settlement for the taking of said property or property rights and all damages occasioned to the residue of his property, and the clerk shall pay to said owner the amount deposited with him, and the court, at its next term, shall enter a

decree divesting the title to said property or property rights out of the owner and vesting the same in the condemner.

23-1532. Trial when property owner does not accept deposit.—If the owner is not satisfied with the amount assessed by the condemner, he shall, on or before the second day of the regular term of the court next, after the serving of said notice, appear, except to the amount assessed by the condemner, and thereupon a trial may be had before a petit jury as other civil actions are tried.

23-1533. Payment of amount deposited pending trial.—If the owner asks for a trial as provided by § 23-1532 he may, if he so desires, make written request to the clerk to pay to him, without prejudice to the rights of either party, said sum so deposited with the clerk, and the clerk shall pay to said owner the sum so deposited, provided the owner agrees to refund the difference between said sum and the final award in the case if the final award be less than the sum so paid to him or that a judgment may be entered against him in said case for the difference.

23-1534. Default of owner—Case set for hearing.—If the owner does not appear and accept the amount deposited by the condemner as provided in § 23-1531 or does not appear and ask for a trial as provided by § 23-1532, then the petition shall be taken as confessed and the case set for hearing upon the record and in the absence of the owner.

23-1535. Issues confined to amount of compensation—Determination of rights and interest of adverse claimants.—The only issue or question that shall be tried upon exception shall be the amount of compensation to be paid for the property or property rights taken, but in case of adverse claimants of such compensation,

the court may require the adverse claimants to interplead, so as to fully determine the rights and interests of such claimants.

23-1536. Proper party defendant omitted—Amended petition.—If any person who is proper party defendant in said petition shall have been omitted from said petition, amendments to the same may be filed, which amendments, from the filing of the same, shall have the same effect as though contained in said petition.

23-1537. Manner of determining damages to which owner is entitled.—In all instances the amount which an owner is entitled shall be determined by ascertaining the fair cash market value of the property or property rights taken and adding to the same the amount of incidental damage done to the residue of the owner's property, if any, after deducting from said incidental damages to the residue the value of all special benefits, if any, occasioned said residue by the construction of said street, road, highway, freeway or parkway including, but not limited to, increased accessibility to the owner's property, greater convenience in the approach with vehicles, the advantages generally of a front on a more desirable roadway, better drainage, or increased attractiveness.

23-1538. Removal or destruction of a building or structure on land.—When any building or structure is situated wholly or in part upon the land sought to be acquired, the condemner may remove the same to adjoining land of the owner or may divide the same upon the line between the land sought to be acquired and the adjoining land, or may tear down or otherwise dispose of the same.

23-1539. Costs of trial.—If the amount of compensation awarded on the trial shall exceed the amount as-

sessed by the condemner, the condemner shall pay all costs of the case, but if the amount of compensation awarded on the trial is not in excess of the amount assessed by the condemner and deposited with said clerk, the defendant shall pay all costs incident to the trial.

23-1540. Judgment against governmental entities—Payment.—All judgments rendered shall be paid out of the general funds of the municipality, county or state, whichever may be the condemner, together with interest at the rate of six per cent (6%) on any excess of the amount awarded an owner over the amount deposited with the clerk.

23-1541. Provisions supplemental.—Sections 23-1528—23-1541 are not intended to repeal any existing statute relating to eminent domain, but are intended to be an accumulative or supplementary method of acquiring property by eminent domain proceedings.

OPINIONS:

No. 71-1055

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

TOWN PARK HOTEL CORPORATION,
Petitioner-Appellant,
v.
COMMISIONER OF INTERNAL REVENUE,
Respondent-Appellee.

ON APPEAL from the United States Tax Court.

Decided and Filed August 10, 1971.

Before: BROOKS, MILLER and KENT, Circuit Judges.

PER CURIAM. The issue on appeal and before the Tax Court is whether the appellant realized a gain when it withdrew in 1964 a deposit which had been made by the state of Tennessee in a condemnation proceeding in a Tennessee State court involving a taking of the plaintiff's property. The amount deposited by the state and withdrawn by the taxpayer in the year 1964 was the sum of $722,476.00. The Commissioner determined a deficiency in the taxpayer's federal income tax for the fiscal year ended June 30, 1965 in the amount of $112,223.74. He determined that the taxpayer had not reinvested the proceeds received on the condemnation of its property within the time limit as prescribed by section 1033 (a) (3) (B) (i), I.R.C. 1954, and there-

fore that the taxpayer was not entitled to treat the gain thereon as one entitled to nonrecognition treatment. The nonrecognition feature of section 1033(a)(3)(B) in effect at the time here involved was that any taxpayer whose property is involuntarily converted may limit the recognition for tax purposes of any gain realized by such conversion if he replaces such property with other property similar or related in use within a period of one year "after the close of the first taxable year in which any part of the gain upon the conversion is realized."

In this case it is conceded that the taxpayer did not reinvest the proceeds derived from the withdrawal of the condemnation deposit within the one-year period. Its insistence is that the gain was not realized during the year that the deposit was withdrawn but was realized when the amount of compensation that it was to receive as a result of the condemnation was finally determined in a later year in the condemnation proceeding and title to the property was vested by the court in the condemning authority.

In upholding the findings and conclusions of the Commissioner, the Tax Court applied the "claim of right" doctrine first enunciated by the Supreme Court in *North American Oil* v. *Burnet*, 286 U.S. 417, 424 (1932). In that case the doctrine was stated by Mr. Justice Brandeis as follows:

> If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.

The Tax Court analyzed the condemnation procedure in Tennessee (Tenn. Code Ann. [1969 Cum. Supp.] Sections 23-1526 through 23-1541), and was of the opinion that when a deposit is made by the condemning authority under the Tennessee procedure the taxpayer upon withdrawing the deposit obtained the unrestricted use of the funds under a claim of right. The Court was of the view that when the deposit was made in the present taxpayer's case and an order of condemnation entered, the property was thereby appropriated to the use of the state and what remained in the taxpayer was the bare legal title to the property.

Having reviewed the record and the applicable authorities, we are of the opinion that the Tax Court was correct in *North American Oil* v. *Burnet, supra.* It follows that it was correct in its ultimate determination and finding that the taxpayer was not entitled to the benefit of the nonrecognition provisions of the Act in effect during the times here involved.

It is therefore ORDERED and ADJUDGED that the decision of the Tax Court entered on September 14, 1970 be and the same is hereby affirmed on the basis of its memorandum opinion as reported in 29 T.C.M. 1150.

TAX COURT OF THE UNITED STATES

TOWN PARK HOTEL CORPORATION, *Petitioner*
v.
COMMISSIONER OF INTERNAL REVENUE, *Respondent*
Docket No. 2531-69

(Entered: September 14, 1970)

DECISION

Pursuant to the determination of the Court, as set forth in its Memorandum Opinion, filed September 14, 1970, it is

ORDERED AND DECIDED: That there is a deficiency in petitioner's Federal income tax for the fiscal year ended June 30, 1965 in the amount of $112,223.74.

/S/ NORMAN O. TIETJENS
Judge

MEMORANDUM OPINION

TIETJENS, **Judge:** The Commissioner determined a deficiency in petitioner's Federal income tax for the fiscal year ended June 30, 1965 in the amount of $112,223.74. The only issue presented for our decision is whether petitioner reinvested the proceeds received on the condemnation of its property within the time limit of section 1033(a)(3)(B)(i), I.R.C. 1954,[1] and thereby was entitled to treat the gain thereon as one entitled to nonrecognition treatment.

All of the facts have been stipulated. The stipulation and exhibits attached thereto are incorporated herein by this reference.

[1] All statutory references are to the Internal Revenue Code of 1954 unless otherwise specified.

Petitioner, Town Park Hotel Corporation, was incorporated under the laws of the State of Tennessee on December 1, 1952. Petitioner owned and operated a motel, restaurant, and related facilities at the corner of Pennsylvania Street and Crump Boulevard in Memphis, Tennessee. Its common stock was acquired by Holiday Inns of America, Inc. (now Holiday Inns, Inc.) in December 1961. At the time of the filing of the petition herein, the petitioner's principal office was located in Memphis, Tennessee. Petitioner at all times pertinent herein maintained its records and filed its income tax returns on the accrual method of accounting. Corporation income tax returns for its fiscal years ended June 30, 1965, June 30, 1966, and June 30, 1967, were filed with the Internal Revenue Service Center at Chamblee, Georgia, or with the director of internal revenue at Nashville, Tennessee.

On August 14, 1964, the Commissioner of Highways and Public Works of the State of Tennessee filed a petition for condemnation in the Circuit Court of Shelby County, Memphis, Tennessee, against petitioner for the purpose of acquiring a portion of petitioner's land and building. Upon the filing of the petition the State of Tennessee deposited the sum of $722,476 with the court.

The circuit court entered an order of condemnation and appropriation on August 21, 1964, which **inter alia**, sustained the petition of the State of Tennessee as a petition of condemnation as of August 21, 1964; that the land sought in the petition was appropriated to the use of the State; that the State had immediate legal possession of the land; that the State had a right of entry for the purpose of removing the improvements within the right-of-way; and, that petitioner specifically reserved its right to contest the amount of compensation for the taking of the property and incidental dam-

ages. On September 30, 1964, an order of disbursement was signed by the court and the sum of $722,476 was withdrawn by petitioner on that date, and deposited in its bank account. Shortly after receiving the aforementioned deposit, petitioner advanced the amount of the deposit it had withdrawn to affiliated corporations.

The case was set for trial on September 20, 1965, and petitioner was required to waive any interest upon any award in excess of the sum theretofore deposited by the State for the period from May 17, 1965 to September 20, 1965, due to its request for continuances. Pursuant to an oral order of the circuit court the State filed an amendment to petition on March 28, 1966 to correct an error in the description of the property in the petition for condemnation.

On April 16, 1966, the circuit court entered a decree divesting and vesting title and recording jury verdict and entering judgment thereon in the case. In this decree the jury verdict was recited in which petitioner was awarded $725,000 for the land and improvements and, in addition, incidental damages of $215,000, plus interest. Pursuant to this decree, it received the additional sum of $232,792.40, having been adjudged to be the sole owner of the property.

On April 28, 1967, the petitioner expended the sum of $1,678,781.34 for the purchase of a 132-unit motel in Santa Monica, California from its parent, Holiday Inns, Inc. This property is similar and related in service and use to the motel property condemned by the State of Tennessee as specified in section 1033(a)(3)(A).

In its income tax return for the fiscal year ended June 30, 1965, petitioner reflected that it had a gain of $225,187.76 from the sale of property on September 30,

1964 for a gross sales price of $722,476. On this schedule the petitioner had the following statement:

> The total gain as shown in Column G on involuntary conversion is not recognized in this fiscal year. Town Park Hotel Corporation intends to reinvest entire proceeds in similar property within a year as provided in Section 1033.

In its income tax return for the fiscal year ended June 30, 1966, petitioner reflected that it had gains of $225,-187.76 on September 30, 1964 and $233,727.75 on May 31, 1966, from the sales of property, respectively, on these dates for a gross sales price of $722,476 and $233,-727.75. On this schedule the petitioner had the following statement:

> The total gain as shown in Column G on involuntary conversion is not recognized in this fiscal year. Town Park Hotel Corporation intends to reinvest entire proceeds in similar property within a year as provided in section 1033.

At the bottom of this Schedule D petitioner had the following "Note":

> Offer in settlement received September 1964. Lawsuit filed and settled in Jury trial May 1966 with total award of $956,203.75.

The petitioner did not make application for an extension of time within which to replace the property condemned and converted by the State of Tennessee in the litigation as provided in section 1033(a) (3) (B) (ii).

The Commissioner determined that petitioner had not reinvested the proceeds from the condemnation of its property within "one year after the close of the first

taxable year in which any part of the gain * * * is realized," i.e. within the year following its fiscal year ended June 30, 1965, since the petitioner made the withdrawal from the circuit court on September 30, 1964. Therefore petitioner was not entitled to the nonrecognition feature of section 1033 (a) (3) (A). The parties have stipulated that the gain on withdrawal of the funds in 1964 is in the amount of $449,754.33 computed as follows:

Realized Gain on Receipt of Condemnation Proceeds for the Fiscal Year Ended 6/30/65

Condemnation deposit withdrawn on September 30, 1964		$722,476.00
Cost or other basis of all land and depreciable assets	$1,174,275.21	
Less cost of assets not condemned	402,059.34	
Cost of assets condemned	$ 722,215.87	
Depreciation allowed or allowable with respect to these assets	499,494.20	272,721.67
Gain on condemnation		$449,754.33

The sole issue facing us is whether petitioner reinvested proceeds from condemnation within the applicable time limit to be able to avail itself of the nonrecognition of gain provision of section 1033, which provides in pertinent part:

SEC. 1033. INVOLUNTARY CONVERSIONS.

* * *

(3) Conversion into money where disposition occurred after 1950.—

(A) Nonrecognition of gain.—If the taxpayer during the period specified in subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock. * * *

* * *

(B) Period within which property must be replaced.—The period referred to in subparagraph (A) shall be the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is the earlier, and ending—

(i) 2 years[2] after the close of the first taxable year in which any part of the gain upon the conversion is realized, or

Petitioner contends that as an accrual basis taxpayer it did not realize gain from the condemnation until fiscal year ended June 30, 1966, when the damages were fixed and title vested in the State, and therefore by reinvesting the proceeds in similar property during fiscal year ended June 30, 1967, it complied with the statute. The

[2]The time limit of 2 years was added by section 915(a) of the Tax Reform Act of 1969 and applies to the disposition of converted property occurring after December 30, 1969. For prior years, which includes the year in question herein, 1965, the applicable time limit of section 1033(a)(3)(B)(i) is one year.

Commissioner counters by saying that part of the gain was realized during fiscal year ended June 30, 1965, i.e. on September 30, 1964 when petitioner withdrew $722,476 from the circuit court, and therefore it had to reinvest by June 30, 1966 to avail itself of the nonrecognition provision of section 1033. We agree with the Commissioner.

The issue herein is controlled by the oft-cited case of **North American Oil v. Burnet**, 286 U.S. 417, 424 (1932), wherein Mr. Justice Brandeis stated:

> If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.

We have undertaken an investigation of the law of Tennessee because rights in the sphere of eminent domain rest in the laws of the State. **Harry D. Aldridge**, 51 T.C. 475 (1968). This investigation[3] discloses the following procedure for condemnation proceedings and convinces us that petitioner withdrew the funds under a claim of right. The State deposits in court the amount it determines to be the damages to which a property owner is entitled by reason of the exercise of the power of eminent domain. The owner, if he is not satisfied with this amount, may ask for a jury trial solely on the issue of the amount of compensation to be paid for the property taken. However, such action does not impair his ability to request the clerk of the court to pay over to him, prior to trial, the amount deposited, subject to refund-

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[3]Tenn. Code Ann., sec. 23-1528-30; 23-1532-33; and 23-1535 (Cum Supp. 1969).

ing the difference if the final award be in a lesser amount or to a judgment being entered against him for the difference.

The above procedure was followed by the State and petitioner. Petitioner did in fact withdraw the funds and expend them in the form of advances to its affiliates. However, petitioner says that this did not amount to receipt under a claim of right and cites **Healy v. Commissioner**, 345 U.S. 278 (1953). However a reading of **Healy v. Commissioner, supra** at 282, brings to light this statement:

> There is a claim of right when funds are received and treated by a taxpayer as belonging to him. The fact that subsequently the claim is found to be invalid by a court does not change the fact that the claim did exist. A mistaken claim is nonetheless a claim, • • •

We feel this statement adequately meets and disposes of petitioner's argument that it had no claim of right because the State could have withdrawn from the condemnation proceedings at any time thereby forcing petitioner to return the money to the State.

Petitioner's argument that no gain was realized until legal title passed under the decree of April 16, 1966 is not well taken. By virtue of the condemnation order of August 21, 1964, petitioner's land was appropriated to the use of the State; the State obtained immediate legal possession and the State obtained a right of entry to remove all improvements within the right-of-way. What remained for petitioner thereafter amounts to no more than bare legal title. Similar circumstances existing in **Harry D. Aldridge, supra**, did not there prevent a finding of gain realized prior to the passing of

title, and we are aware of no valid reason why the basic reasoning therein is inapplicable here; **to wit, the right** to possession passed exclusively to the State coupled with a deposit in court by the condemnor, making the events resemble a "contract of sale where the benefits and burdens have passed to the purchaser." **Harry D. Aldridge,** supra at 480.

Petitioner's argument that as an accrual basis taxpayer it was not required to report the amount of gain until fiscal year ended June 30, 1966 because prior thereto neither the right to receive such income nor the amount thereof could be reasonably determined is to no avail in light of **Whitaker** v. **Commissioner,** 259 F.2d 379 (C.A. 5, 1958), affirming 27 T.C. 399. That case states, at 382:

> The claim of right doctrine is firmly established in our tax law.[3] If a taxpayer receives earnings under a claim of right, without restriction as to its use, it is taxable income in the taxable year when he receives the earnings. The principle applies even though in a later year he may be required to refund all or part of the money. **It applies whether returns are on the cash or accrual basis.** Any amount repaid is deductible in the year of repayment (on the cash basis) or the year in which the liability to repay becomes fixed (on the accrual basis). * * * [Footnote omitted; emphasis supplied.]

We conclude that petitioner, to avail itself of nonrecognition treatment, was required to reinvest the proceeds from condemnation no later than fiscal year ended June 30, 1966, since part of the gain upon conversion was realized within fiscal year ended June 30, 1965; specifically on September 30, 1964, when petitioner

withdrew $722,476 from the circuit court under a claim of right since petitioner received and treated such funds as its own, depositing them in its bank account and by advancing them to its affiliates. **Healy v. Commissioner, supra.** Accordingly,

Decision will be entered for the respondent.